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SEP 27 1995

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Review of the Commission's	)	MM Docket No. 95-90
Regulations Governing Broadcast	)	
Television Advertising	)	

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REPLY COMMENTS OF CBS INC.

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SUMMARY

Those commenters opposing repeal of the rule offer no analysis or data that persuasively contradict the fundamental economic facts that both markets relevant to the repping rule -- the national advertising market and local programming markets -- are now highly competitive, and that significant competition in either of these markets would, by itself, be sufficient to guard against the abuses that the repping rule was enacted to prevent.

Like other opponents of repeal, the Stations Representative Association ("SRA"), offers only conclusory assertions that a network-owned rep would find itself serving conflicting interests. SRA also appends an analysis prepared bv MiCRA, purporting to demonstrate a theoretical basis for the notion that repeal of the repping rule might result in anticompetitive effects. CBS herewith submits a critique by Wilkofsky Gruen Associates which demonstrates convincingly that the MiCRA Analysis and the SRA Comments themselves identify no theoretical or empirical basis for anticipating anticompetitive behavior in the absence of the repping rule.

The product market definition suggested by the SRA Comments is far too narrow, excluding advertising vehicles, such as national barter syndication and cable network, that are much closer substitutes for network advertising than national spot Indeed, SRA ignores much persuasive evidence that both network advertising and national spot are part of a broad national advertising market encompassing video as well as non-video media -- a market far too unconcentrated to be vulnerable to the kind of price manipulation hypothesized by SRA. The picture that SRA paints, of each particular network competing specifically with its own affiliates in the sale of advertising time, has no basis in reality There is no sense in which a network and its affiliates compete in the sale of advertising, except in the context of the broad national advertising market in which they both participate. In fact, the relationship between a network and its own affiliates is one of

partnership, not mutual competition, given the need of each that the other be strong and prosperous. Moreover, most network time is sold in the "upfront market" before the season even begins. By contrast, all national spot time is sold in the "scatter market." Thus, the price of most network time cannot be affected by price fluctuations that may occur in the national spot market.

The MICRA Analysis proposes to apply the Werden model for "semihorizontal mergers" to prove that the repping of affiliates by a network company may cause network and/or spot advertising to rise in price if they are in "separate relevant product markets." The MICRA Analysis errs, however, in applying this model to a vertical relationship, and the model's stated conditions -- effectively requiring monopolist's power on the part of one merger partner -- cannot possibly be met.

SRA suggests that a rep owned by a network company would be less willing to offer advertisers national spot vehicles that too closely resemble network advertising. But networks do not have the bargaining power to require their affiliates to accept subpar repping services. In order to attract clients, a rep owned by a network company would have to be as innovative and aggressive as independent reps in selling national spot inventories, including offering station lineups that approximate network coverage.

SRA's contention that a network-owned rep will offer programming advice skewed to the interests of its parent network has, in principle, already been rejected by this Commission. And contrary to SRA's assertion, network reps will have no unfair advantage in competing with independent reps for clients.

As networks struggle to preserve the viability of the distribution system on which universal free television depends, nothing less than a showing of compelling public necessity should be required of those who would artificially limit the economic opportunities inherent in networking. That burden certainly has not been met by those who would preserve the repping rule.

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REPLY COMMENTS OF CBS INC.

CBS Inc. ("CBS"), by its attorneys, respectfully submits these Reply Comments in the above proceeding, which the Commission has initiated in order to reconsider whether the rules barring broadcast networks from influencing the rates at which affiliated stations sell advertising time (the "station rate rule")[1] and from representing their affiliated stations in the sale of time to national advertisers (the "repping rule")[2] "continue to effectively serve this Commission's cornerstone interests of promoting diversity and competition."[3] In particular the Commission has inquired "whether networks would have the capability and incentive to exercise undue market or bargaining power in the absence of these rules."[4]

[1] 47 C.F.R. § 73.658(h)

[2] 47 C.F.R. § 73.658(i)

[3] Notice of Proposed Rulemaking ("Notice") at ¶ 2

[4] Id.

I. INTRODUCTION

In our initial comments in this proceeding CBS urged that repeal of the repping rule would confer no market power or undue bargaining power on networks or on any other parties, and that the public interest would be well served by repealing the rule in its entirety.[5] We observed that the two product markets relevant to the repping rule -- the national advertising market and local video programming markets -- have evolved enormously since the rule's adoption in 1959 and are now both extremely competitive These market changes, we urged, have deprived the repping rule of any conceivable purpose because

> -- the intense competition in the national advertising market assures that even if a network's affiliates were willing to allow a network-owned rep to inflate their national spot prices, doing so would be of no value in supporting network prices, since advertiser demand would be redirected toward a host of alternative vehicles; and
>
> -- the intense competition on the supply side of local video programming markets (where six broadcast networks and countless syndicators fiercely compete for outlets) assures that, even if network-owned reps could hope somehow to support network prices by overpricing affiliates' national spot inventories, affiliates have more than adequate bargaining power to prevent their spot revenues from being diverted in this way.

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[5]Comments of CBS Inc., August 28, 1995 ("CBS Comments"). Because there is no reason for any network to wish to control its affiliates' advertising rates, CBS expressed no opinion regarding the station rate rule beyond reciting its general opposition to unnecessary rules of any kind.

We argued that significant competition either in the national advertising market or in local programming markets would by itself be sufficient to guard against the abuses the repping rule is intended to prevent, and that the intensely competitive character of both of these markets provides double assurance that the rule is unnecessary.[6] We also stressed that repeal of the repping rule would in no way diminish diversity in any intellectual market, and that it would promote competition in the repping industry itself.[7]

Those commenters opposing repeal of the rule offered no analysis or data that persuasively contradict any of these fundamental economic realities. Indeed, for the most part, commenters opposing repeal of the rule offered only conclusory assertions based on the assumption that a rep owned by a network company would inevitably find itself serving conflicting interests. One commenter, the Stations Representative Association ("SRA"), while making no departure from this pattern of unsupported conclusory assertions, appended to its comments an economic analysis, prepared by Frederick R Warren-Boulton of MiCRA, purporting to demonstrate a theoretical basis for the notion that repeal of the repping rule might result in anticompetitive effects. It is the SRA Comments and, in particular, the MiCRA Analysis that we wish to address herein. We also submit with these Reply Comments a critique of the SRA Comments and MiCRA Analysis prepared by the firm of Wilkofsky Gruen Associates, Inc., economists specializing in the analysis of electronic media ("W & G Critique"). The W & G Critique demonstrates convincingly that the MiCRA Analysis and the

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[6] CBS Comments at 6

[7] Id. at 21-24.

SRA Comments themselves identify no theoretical or empirical basis for anticipating anticompetitive behavior in the absence of the repping rule

II. THE MICRA ANALYSIS AND THE SRA COMMENTS FAIL TO DEMONSTRATE ANY POTENTIAL ANTICOMPETITIVE EFFECTS THAT WOULD BE CAUSED BY REPEAL OF THE REPPING RULE

Both the MiCRA Analysis and the SRA Comments present a thoroughly unrealistic picture of the competitive environment in which network advertising and national spot operate. This picture, painted without a scintilla of supporting data, is then used as the backdrop for unsupported speculation of competitive harm that might result from the repeal of the rep rule. Resting as they do on a distortion of the relevant product markets, these speculations cannot possibly constitute a reasonable basis for barring network companies from the repping industry.

A. The Product Market Definition Suggested By The SRA Comments Is Far Too Narrow And Excludes Closer Substitutes For Network Advertising Than National Spot.

In its initial Comments, CBS cited an extensive study by Economists Inc.[8] which identified much persuasive evidence that network and national spot do not compete for advertisers in separate and distinct product markets (as the Department of Justice[9] and,

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[8] An Economic Analysis of the Broadcast Television National Ownership, Local Ownership and Radio Cross-Ownership Rules, Economists Incorporated, (May 17, 1995) ("Joint Ownership Study"), which was commissioned by Capital Cities/ABC, Inc. ("ABC"), CBS, National Broadcasting Company, Inc. ("NBC") and Westinghouse Broadcasting Company ("Westinghouse") in connection with the Commission's current rulemaking proceeding on broadcast station ownership (MM Docket No.91-221 & 87-8).

[9] Department of Justice Comments in Gen.Docket No. 83-1009 (Multiple Ownership), February 21, 1984, at 14-16

tentatively, the Commission itself[10] had earlier opined), but rather compete along with other video and non-video media, such as barter syndication, cable (network and national spot), radio (network and national spot), magazines, newspapers. outdoor advertising and direct marketing, in one vast national advertising market.[11] We observed that this market is extremely unconcentrated[12] -- so much so that even if it is subdivided, using inappropriately narrow product market definitions. the resulting segments are themselves highly unconcentrated. Thus, for example, an all-video national advertising market, consisting only of broadcast and cable network, national spot and national syndication has a Herfindahl-Hirschman Index ("HHI") of 850 -- well below the 1000 level considered by the Department of Justice to be the threshold of moderate concentration.

In its Comments, SRA -- offering no empirical evidence whatsoever -- suggests the existence of a remarkably narrow product market, consisting solely of network and national spot advertising. Although cable network advertising, which offers national coverage in a single transaction, actually would appear to be a much closer substitute for network advertising than

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[10]Further Notice of Proposed Rulemaking in MM Docket No.91-221 & 87-8, released Jan. 17, 1995 ("Ownership FNPRM"). Clearly, if the Justice Department's comments and the tentative conclusions of the Commission's Ownership FNPRM are correct -- if network and national spot advertising participate in different markets -- then a network company's repping of its affiliates cannot possibly reduce competition in either market. and there is no economic basis at all for the repping rule.

[11]Joint Ownership Study at Appendix D.

[12]Properly defined to encompass video and non-video alternatives, the national advertising market in which broadcast network and national spot compete has a Herfindahl-Hirschman Index ("HHI") of only 134, indicating an extreme lack of concentration. Joint Ownership Study at 28. (Under the Department of Justice/Federal Trade Commission Merger Guidelines, HHIs less than 1800 indicate moderate concentration and HHIs below 1000 indicate low concentration.)

national spot, the SRA Comments dismiss it as a broadcast network competitor on the grounds that cable network programs typically reach smaller audiences than broadcast network programs.[13] No explanation is offered for why low-rated programs do not compete in the same advertising market as high-rated programs, a concept particularly difficult to fathom in light of the fact that the median broadcast network *primetime* program typically reaches less than twelve percent of television homes.[14]

Most surprising of all in SRA's description of the market in which network advertising and national spot compete is its complete silence on the subject of barter syndication -- this, despite the fact that national barter syndication is undoubtedly the closest substitute of all to broadcast network advertising, permitting national broadcast coverage in a single transaction. These omissions are highly significant since national syndication and cable network advertising constitute the fastest growing components of the national advertising market's video segment.[15] Needless to say, non-video media and emerging video technologies such as DBS were not proposed as candidates for inclusion in the product market depicted in the SRA Comments.

Even accepting, arguendo, a market in which network advertising and national spot are the sole competitors, SRA's description of that competition makes no sense. The picture that

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[13] SRA Comments at 13-14

[14] See, e.g., "Ratings: Week 16," Broadcasting and Cable, January 16, 1995 at 98; "People's Choice," Broadcasting and Cable, September 18, 1995 at 32. Moreover, SRA does not explain why it does not also exclude low-rated broadcast network programs from its product market definition, or why high-rated cable network programs should not be included.

[15] From 1983 to 1988, national advertising revenues for syndication and for cable more than tripled. From 1988 to 1993, syndication advertising revenues increased by 74.9% and national cable advertising revenues more than doubled, while the combined advertising revenues of the broadcast networks increased by only 11.3% -- even though the revenues of a fourth network (Fox) were added during this period. See, Notice at Appendix A.

SRA paints, of each particular network competing specifically (and it would seem, to hear SRA tell it, exclusively) with its own affiliates in the sale of advertising time, has absolutely no basis in reality. There is no sense in which a network and its affiliates compete in the sale of advertising, except in the context of the broad national advertising market in which they both participate -- all broadcast network advertising competing with all national spot sales by all affiliated and independent stations and with a wide array of other national advertising vehicles.

In fact, as the W&G Critique emphasizes, the relationship between a network and its own affiliates is one of partnership, not mutual competition. In order to achieve the widest possible exposure for its own programs, a network needs affiliates that are strong and prosperous -- affiliates with well-funded local news operations[16] and strong promotion departments. If there is one broadcaster other than itself to which a network wishes great commercial success, it is its own affiliate.

Moreover, as the W&G Critique observes, the nature of network and national spot advertising is such that occasions to choose between them are fairly infrequent for advertisers. Most network time is sold in the "upfront market" before the season even begins. The remainder is sold in the "scatter market" at or near the time of broadcast. By contrast, all national spot time is sold in the "scatter market." Thus, the price of most network time cannot possibly be affected by price fluctuations that may occur in the national spot market.[17]

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[16]The W&G Critique points out that the station with the strongest early evening news program typically garners the highest ratings in its local market, sign-on to sign-off, regardless of its network affiliation. W&G Critique at 9, n.3

[17]Id. at 8-9.

B. <u>The MiCRA Analysis Fails To Demonstrate That Repeal Of The Repping Would Result In Increased Prices For Advertisers.</u>

Notwithstanding the foregoing and considerable other evidence that a network cannot support its own prices by manipulating its affiliates' spot prices, the MICRA Analysis proposes to apply a model for "semihorizontal mergers" developed by Werden -- a model that according to MICRA, demonstrates that the repping of affiliates by a network company may cause network and/or spot prices to rise "if network and spot advertising are in separate relevant product markets." MICRA, however, candidly identifies conditions to the application of this model -- conditions which would make its application seem quite far fetched. Thus, for example, MICRA begins by stating that the hypothesized price increase could occur only if either

> "(i) network advertising is a relevant product market in which Rep Rule constrained networks have a dominant share, or
>
> "(ii) national spot advertising is a relevant product market in which Rep Rule constrained network affiliates have a dominant share in at least some local markets."[18]

Of course, if one were to define a product market consisting solely of broadcast network advertising, then obviously broadcast networks *collectively* would have a dominant share in that market, just as car manufacturers collectively and frozen pizza manufacturers collectively have dominant shares -- indeed, 100% shares -- of the car and frozen pizza markets. But no one network has a dominant share of a hypothesized "network market." Similarly, there are few local television markets where one affiliate can be said to dominate even a local advertising

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[18]<u>MiCRA Analysis</u> at 3-4

product market defined to include only broadcast stations. And, of course, if the national and local advertising markets in which network advertising, national spot and local spot compete are accurately defined to encompass the many media that compete with them, then even collectively, networks do not have a dominant share of their markets and affiliates do not have dominant shares of their markets. This threshold condition to application of the Werden model cannot be met.

At the conclusion of its discussion of the Werden model, the MICRA Analysis states that there are two "hurdles" in applying this model to the situation of a network company repping affiliates:

> " First, elimination of the Rule must grant the network some control over an affiliate's price, just as a merger would eliminate independence in the pricing of two firms' products. Control could take the form of the network dictating prices for the affiliate's national spot advertising that are above the level that would maximize the affiliate's profits."[19]
>
> "The second hurdle in applying Werden's analysis to elimination of the Rep Rule is that it would seem to require either a network or an affiliate to have unilateral market power."[20]

The W&G Critique demonstrates that neither of these analytical hurdles can possibly be cleared. No rep can dictate or even influence its client station's prices for the simple reason that there is only one price at which a rep can sell time -- the market price.[21] Underpricing or overpricing would immediately show up as a shortage in the supply of, or demand for, the affiliate's time. A

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[19] Id. at 7.

[20] Id. at 8.

[21] W&G Critique at 14-16.

rep that priced his client's inventory significantly above the market would simply fail to sell any time at all.[22]

Moreover, entirely absent from both the MiCRA Analysis and the SRA Comments is any empirical evidence that networks have the bargaining power to extract from their affiliates the sacrifices that would be required of them if their national inventories are to be offered at suboptimal prices. Indeed, in its initial Comments CBS cited considerable evidence indicating a substantial shift in the relative bargaining power of networks and affiliates in favor of the latter.[23] The W&G Critique points to a pattern of superior bargaining power, especially among VHF affiliates with strong local news departments[24] -- the very major market affiliates that would seem to be indispensable to any conceivable strategy of spot price manipulation undertaken by a faithless rep to support its network prices. These affiliates certainly have sufficient bargaining power to resist the imposition of suboptimal prices on their national spot inventories -- inventories that generate roughly half of their revenues.

The second analytical hurdle identified by MiCRA -- i.e., that either the network or its affiliate has "unilateral market power" -- would seem, on its face, to be utterly impossible to clear. Certainly, the MiCRA study cites no evidence, nor could it, that any network or any affiliate has anything even remotely resembling unilateral market power -- the power to set prices and make them stick. Indeed, the MiCRA Analysis seems tacitly to acknowledge that no network or affiliate has unilateral market power when the analysis suggests that the requirement

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[22]Id.

[23]CBS Comments at 16-18

[24]W&G Critique at 9-10

for such power on the part of a single firm might be met instead, somehow, by the occurrence of multiple "mergers" -- i.e., that "two or more networks [will come to] represent many of their affiliates" if the Rep Rule is repealed.[25] The MiCRA analysis states that "the combined effects [of these multiple "mergers"] is then likely to be far greater than the sum of the effects if each were done separately," but leaves to the reader's imagination why this would be equivalent to one firm's achieving unilateral market power. Certainly we are at a loss to imagine the equivalency. Indeed, it would seem that even if every network, new and emerging, came to rep every one of its affiliates -- a highly improbable scenario -- the result would be vigorous competition among six well-funded firms.[26]

It would seem, then, that the market conditions bearing on network and national spot advertising fail every condition to the applicability of the Werden model for "semihorizontal" mergers. The MiCRA Analysis, thus, has not demonstrated even the mathematical possibility-- much less the real-world probability -- of any adverse effect on prices that would derive from

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[25]MICRA Analysis at 8.

[26]Indeed, if every network repped all of its affiliates, and one were to impute to the rep complete authority, tantamount to ownership, over pricing decisions, and even if one were to assume (as SRA does) a product market consisting solely of network advertising and national spot, the resulting market would still be only moderately concentrated, measured by capacity. (Because of the extreme volatility of audience ratings and advertising revenues, the capacity of each firm to present national advertising -- i.e., their network and national spot inventories -- would appear to be the most appropriate measure of each firm's economic potential.) Given their roughly equal capacities (when network plus national spot inventories are totalled), each firm would be attributed a 1/6, or 16.67% share, of this hypothetical market, yielding an HHI of 1667 - - still well within the moderate range. (The HHI for a market is calculated by calculating each competitor's percentage share of the market (generally measured by either each firm's revenues or productive capacity), squaring each share, and then totalling the squared shares -- in this case 6 x $(16.67)^2$). Of course, a product market definition that encompasses only network advertising and national spot is vastly underinclusive. A more reasonable product market definition would yield a far lower level of concentration.

repeal of the rep rule.

C. <u>The MiCRA Analysis Does Not Demonstrate That Reps Owned By Network Companies Would Be Less Competitive With Network Advertising Than Independent Reps.</u>

In another oblique approach to identifying some possible anticompetitive effect that might be threatened by repeal of the rep rule, the MiCRA Analysis proposes that the substitutability of national spot for network advertising has been enhanced by the readiness of independent reps to adopt innovations such as "unwired networks." The suggestion is that a rep owned by a network company would be less willing to offer advertisers national spot vehicles that too closely resemble network advertising. But again, in the absence of any evidence that networks have the bargaining power to require their affiliates to accept subpar repping services, there is every reason to believe that in order to attract clients a rep owned by a network company would have to be as innovative and aggressive as independent reps in selling national spot inventories, including offering station lineups that approximate network coverage. Any rep that failed to participate in "unwired networks" or other effective sales vehicles would simply "flunk out" of the repping business. And because other reps will continue to offer "unwired networks" and other innovative products to advertisers, the failure of a network-owned rep to do so would not necessarily redirect any demand toward conventional networks, much less to the rep's particular parent network. The network-owned rep would be sacrificing commissionable business and gaining nothing.

D. SRA's Contention That A Network-owned Rep Will Offer Programming Advice Skewed To The Interests Of Its Parent Network Has, In Principle, Already Been Rejected By This Commission.

In its Comments, SRA asserts that reps owned by network companies would function differently as program advisers from other reps -- that their advice would be skewed so that "programming not provided by the network would have an even tougher time of getting on the air."[27] But, again, neither the SRA Comments nor the MiCRA Analysis cite a shred of evidence that networks have the bargaining power over their affiliates to require them to accept under-performing reps, whether that underperformance is reflected by self-interested programming advice or in any other way. Indeed, as CBS observed in its initial comments, stations are quite capable of evaluating a rep's programming advice in light of any theoretical conflict that might arise from the programming activities of the rep's parent firm, and do so currently. For example, two of the most important reps, Blair and Telerep, have had active roles in program production and syndication through their wholly-owned subsidiaries, Blair Entertainment and Television Program Enterprises.

Indeed, in a closely related context, the Commission expressly found that such programming advice as was provided by sales representatives posed no threat to program diversity. Thus, in repealing its so-called Golden West policy in 1981,[28] which prohibited the representation of a station by an organization owned in whole or in part by the owner of a

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[27] SRA Comments at 25

[28] Report and Order in BC Docket No. 80-438, 87 FCC 2d 668 (1981) ("Golden West Policy Repeal").

competing station in the same market, the Commission noted:

> "With regard to the issue of influence over programming, we do not find a problem of such magnitude that Golden West should remain as a policy. Even those commenters that argue for retention of the policy point out that programming advice is not forced upon the station. Rather, the station typically solicits the advice of the station rep firm."[29]

The Commission recognized that the natural incentive of all stations to maximize their revenues would provide ample protection against any possible conflicts. The Golden West policy was made unnecessary, the Commission observed, "by the incentive of the unaffiliated station to seek the sales representative that will most vigorously serve its interest."[30] The Commission noted that "[i]f that representation fails to produce the expected results, a change will be made" and concluded that rep firms would be "motivated to provide maximum service to each client."[31]

E. Network Reps Will Have No Unfair Advantage In Competing With Independent Reps for Clients.

The fear expressed in the SRA Comments that reps owned by network companies would enjoy an unfair advantage in competing for clients with independent reps[32] makes no sense absent evidence that networks have sufficient unspent bargaining power to require their affiliates to accept subpar representation. The SRA Comments propose that in light of the Commission's

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[29]Golden West Policy Repeal, supra, 87 FCC 2d at 680 -81.

[30]Id. at 680.

[31]Id.

[32]SRA Comments at 15-17

repeal of the financial interest and syndication rules, networks may gain "powerful leverage" in winning clients if they have "a popular show for syndication" -- i.e., that the network would tie licensing of the program to the affiliate's willingness to be repped by the network company.[33] The W&G Critique demonstrates that this scenario has no logical basis.[34] There is no sound reason for the network to exploit its popular program in so convoluted a fashion, rather than to pursue that familiar favorite, a large cash return Of course, any rep, network or otherwise, is capable of attempting to win clients by offering them incentives such as upfront payments, discount rates or any of a host of alternatives. Indeed, independent reps such as Blair and Telerep are themselves syndicators of programming and are equally capable of adopting the same convoluted strategy proposed by SRA for network reps.

In reality, any success that a network-owned rep may have in attracting and keeping clients will be attributable to superior service and only to superior service. If a rep owned by a network company is able to bring enhanced efficiencies to national spot sales, then it is in the public interest for that rep to succeed at the expense of less efficient competitors. If, on the other hand, the network-owned rep fails to achieve superior efficiencies, then it ought to, and most assuredly will, fail. Neither the SRA Comments nor the MiCRA Analysis identifies any evidence of market conditions that would lead to any other result The protection from competition that SRA seeks to preserve for its members is contrary to the public interest.

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[33] Id. at 16-17.

[34] W&G Critique at 24-25.

III. CONCLUSION

At a time when networks are struggling to preserve the viability of the distribution system that is the foundation of universal free television, nothing less than a clear showing of compelling public necessity should be required of those who would artificially limit the economic opportunities inherent in networking. That burden certainly has not been met by those who would preserve the repping rule; indeed, SRA concedes that many of the concerns it raises regarding possible manipulation by a network-owned rep of its affiliate clients' national spot prices are "conjectural."[35] Proponents of the rule's repeal, on the other hand, have demonstrated clearly and convincingly that the rule does not serve to protect competition or diversity and unnecessarily restricts competition in the repping industry itself -- all the while imposing needless obstacles to the realization of networking's full economic potential. We strongly urge the Commission to repeal the repping rule.

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[35] SRA Comments at 24

Respectfully submitted,

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A Critique of the Comments of the Station Representatives Association and the MiCRA Analysis With Regard to MM Docket No. 95-90

I. Summary

The Comments of the Station Representatives Association ("SRA Comments") and the *Economic Analysis of the Competitive Effects of Eliminating The Network Representation Rule* ("Analysis") prepared by Frederick R. Warren-Boulton of MiCRA contain at least three underlying analytical errors from which a host of mistaken conclusions are derived. First, the SRA Comments and the Analysis use economic models based on principles of horizontal mergers to analyze a repping (sales) arrangement between a network and its affiliated stations. The relationship between a network and its affiliates, however, is a vertical relationship. Moreover, not only are the models inappropriate, but even employing their own operative criteria, these models could not conceivably apply to the network-affiliate marketplace. Second, the SRA Comments and Analysis assume that the television networks can compel their affiliates to engage in behavior that is inimical to their own economic interests, although no mechanism or theory (let alone evidence) is presented as to how or why the affiliates would accept such an arrangement. Third, the SRA Comments and Analysis assume that it is in the television networks' individual economic interest to impose above-market spot prices on their affiliates.

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In fact, even if an individual network had the power to engage in such behavior, it would confer an economic windfall on its rivals and damage its own economic interests.

Indeed, if the assumption universal to economic analysis that all parties try to engage in their own economic self-interest is made, it becomes clear that the various scenarios presented in both the SRA Comments and the Analysis could not possibly occur.

Part II discusses the relationship between the television networks and their affiliated stations, while Part III examines the economics of television advertising. With this background established, we then examine each of the various scenarios presented in the SRA Comments and Analysis in Parts IV to X. By taking into account the likely step-by-step actions of each party for each scenario, and assuming each is rational and wishes to maximize its own profits, we demonstrate how all of these scenarios could not possibly occur unless both the networks and their affiliated stations consciously engage in behavior manifestly destructive to their economic self-interest.

II. The Relationship Between Networks and Their Affiliated Stations

In economic terms, the networks and their owned and operated stations (and by extension their non-owned affiliates) have a vertical rather than a horizontal relationship. Stations give the networks access to local markets. The networks, in turn, supply programs to the stations and pay the stations to air their programs. In return, the stations cede to the networks most of the commercial inventory available during the period when a network program is aired.

Thus, the networks and the stations are partners, not competitors. It is in the interest of a network to have a strong affiliate since that affiliate will deliver a larger audience to the network schedule. It is in the interest of an affiliate to have a strong network since the network will deliver higher ratings and a larger audience for surrounding local programs, and provide large audiences for the periods when adjacencies are sold.

The affiliation arrangement contains an economic trade-off. The opportunity cost incurred by the television stations in giving up inventory is compensated by a cash payment (compensation) plus a free program. A station is constantly evaluating that trade-off. When the value of a station's commercial inventory exceeds the costs of losing the cash compensation plus the cost of paying for a substitute program of equal quality, the station will not air the network program. This is the classic relationship between a seller and buyer, a vertical relationship, not a relationship of two sellers of the same product. a horizontal relationship.

Indeed, there is actually very little interaction between the sale of network and station advertising. Television stations retain all of the commercial inventory for programs they themselves originate (local news and other local programming), and a large proportion of the inventory for programs acquired in the syndication market. (Barter syndication, a third national television advertising outlet, consumes a portion of the inventory for syndicated programs.) During dayparts when network programs are shown, by contrast. the stations have at their disposal only a small portion of the inventory. Most of the commercial inventory for these programs is retained by the network. Consequently, a majority of the commercial inventory that the stations have available to sell is inventory during dayparts when the networks are not providing programs to the stations.[1] For this reason, despite

[1] The typical network affiliate generates 35 percent of its revenue during the early evening and late evening news, and an additional 20 percent during the 3 hours of non-news programming prior to prime time. Only 17 percent of a station's revenue is generated in prime time. Special Analysis. Wilkofsky Gruen Associates, 1992.